KPMG

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

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Independent Auditors' Report

The Board of Directors
Economic Development Bank for Puerto Rico:

We have audited the accompanying basic financial statements of the business-type activities, the major fund and the remaining fund information of Economic Development Bank for Puerto Rico (the Bank), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2010 and 2009, which collectively comprise the Bank's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, its major fund and the remaining fund information of Economic Development Bank for Puerto Rico as of June 30, 2010 and 2009, and the respective changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 10 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 30, 2010

Stamp No. 2471999 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

This financial discussion contains an analysis of the statements of net assets of the Economic Development Bank for Puerto Rico (the Bank) as of June 30, 2010 and 2009, and its changes in financial position for the years then ended. The information included in this section should be read in conjunction with the basic financial statements of the Bank and its notes.

The business-type activities of the Bank are accounted as enterprise funds, which include the activities of the Bank's principal operating fund and those of the Bank's blended component unit, Economic Development Bank Capital Investment (EDBCI). EDBCI was created to account for and focus separately on the activities and investments in local equity capital and venture capital funds, formerly addressed within the Bank. The required financial statements for an enterprise fund are as follows: statement of net assets; statement of revenue, expenses, and changes in net assets; and statement of cash flows. These financial statements report information using accounting methods similar to those used by private financial institutions.

The statement of net assets includes all the Bank's assets and liabilities, classified as current, noncurrent, capital assets, and net assets. This statement provides information as of a specific date about the nature and amount of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the Bank's capital structure.

The statement of revenue, expenses, and changes in net assets includes revenue earned and expenses incurred by the Bank for a specific period of time (12 operating months beginning on July 1 and ending on June 30). This statement measures the results of the Bank's operation and can be used to determine whether the Bank has successfully recovered all its costs through user fees and other charges. This statement distinguishes interest and noninterest revenue and expenses.

The statement of cash flows reports cash receipts, cash payments, and changes in cash resulting from operations, noncapital financing, capital and related financing, and investing activities. This statement provides information about the Bank's cash flows and how cash is obtained, used, and what was the change in cash balance during the reporting period beginning on July 1 and ending on June 30.

Financial Highlights

- Operating income increased $17.9 million or 112%, from a $16 million operating loss in 2009 to a $1.9 million operating income in 2010.
- Interest income from loans increased by $1.4 million or 13.1%, from 10.3 million in 2009 to $11.7 million in 2010.
- Total interest income from investments decreased by approximately 35.1% or $20.4 million, from $58 million in 2009 to $37.6 million in 2010. Total interest expense decreased by 41.1% or $18.6 million, from $45.4 million in 2009 to $26.8 million in 2010.
- Net increase in fair value of investments amounted to $6.5 million in 2010, a $9.9 million or 286.6% rise from a $3.5 million net decrease in fair value of investments in 2009.
- Provision for loan losses decreased by $10.2 million or 43%, from $23.7 million in 2009 to $13.5 million in 2010.

- The Bank received a $30 million capital contribution from the Executive Branch of the Commonwealth of Puerto Rico.

Comparison of 2010 and 2009 Assets, Liabilities, and Net Assets

Condensed financial information on assets, liabilities, and net assets is presented below (dollar amounts in thousands):

Net assets		2010	2009	Increase (decrease) Amount	Increase (decrease) Percentage
Current assets	$	267,152	232,356	34,796	14.98%
Noncurrent assets		928,039	728,201	199,838	27.44
Total assets	$	1,195,191	960,557	234,634	24.43
Current liabilities	$	455,911	435,815	20,096	4.61
Noncurrent liabilities		594,301	411,682	182,619	44.36
Total liabilities		1,050,212	847,497	202,715	23.92
Net assets:					
Invested in capital assets, net of related debt		(1,239)	(1,241)	(2)	0.16
Restricted for special loan programs		8,889	9,227	(338)	(3.66)
Unrestricted		137,329	105,074	32,255	30.70
		144,979	113,060	31,915	27.20
Total liabilities and net assets	$	1,195,191	960,557	234,630	24.43

At June 30, 2010, the Bank's total assets were $1,195.2 million ($314 million from EDBCI) compared to $960.6 million at June 30, 2009 ($308 million from EDBCI). The increase of $234.6 million represents 24.4% of the 2009 total assets balance.

Total loan portfolio decreased by 2.1% when compared to balances as of June 30, 2009. Loan disbursements decreased from $107.1 million in 2009 to $85.1 million in 2010, while principal collected on loans decreased from $68.2 million for fiscal year 2009 to $67.3 million for fiscal year 2010. The related allowance for loan losses decreased by $8.1 million or 17% of the 2009 balance, mainly due to an increase in loans charged-off during the period. Charge-offs increased from $8.6 million in 2009 to $23.3 million in 2010. The net loan portfolio increased by $2.6 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell increased by $225.9 million when compared to balances as of June 30, 2009, mainly due to the issuance of $176.5 million in promissory notes.

(Continued)

At June 30, 2010, the Bank's total liabilities were $1,050.2 million compared to $847.5 million at June 30, 2009. The increase of $202.7 million represents 23.9% of the 2009 total liabilities. This increase is mainly due to a $176.5 million increase in promissory notes.

Total time deposits were $385.3 million as of June 30, 2010. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $317.1 million. Deposits from other financial institutions were $68.2 million. Total time deposits increased by $33.6 million. As of year-end, the total promissory notes and other note payable balance was $467.1 million.

Securities sold under agreement to repurchase decreased by $6.7 million, from $184.5 million in 2009 to $177.8 million in 2010. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.

The Bank had net assets of $145 million at June 30, 2010, an increase of $31.9 million or 28.2% when compared to June 30, 2009. This increase is primarily due to the $30 million capital contribution received during 2010. Additional information about net assets composition is presented in note 11 to the basic financial statements.

Comparison of 2010 and 2009 Revenue, Expenses, and Changes in Net Assets

Condensed financial information on revenue, expenses, and changes in net assets is presented below (in thousands):

Revenue, expenses, and changes in net assets		2010	2009	Increase (decrease) Amount	Increase (decrease) Percentage
Interest income from loans	$	11,673	10,320	1,353	13.11%
Interest income from investments		37,623	58,002	(20,379)	(35.13)
Total interest income		49,296	68,322	(19,026)	(27.85)
Total noninterest income (loss)		4,679	(2,418)	7,097	293.51
Total operating revenue		53,975	65,904	(11,929)	(18.10)
Provision for loan losses		13,485	23,675	(10,190)	(43.04)
Total interest expense		26,741	45,361	(18,620)	(41.05)
Total noninterest expenses		11,830	12,886	(1,056)	(8.19)
Total operating expenses		52,056	81,922	(29,866)	(36.46)
Operating income (loss)		1,919	(16,018)	17,937	(111.98)
Capital contribution		30,000	—	30,000	N/A
Net income and change in net assets	$	31,919	(16,018)	47,937	299.27

For the year ended June 30, 2010, the Bank presents an operating income of $1.9 million when compared to the operating loss of $16 million for the year ended June 30, 2009. The increase in operating income resulted from the net effect of the following:

(a) Interest Income

Total interest income decreased by approximately 27.9% or $19 million, from $68.3 million in 2009 to $49.3 million in 2010. This decrease in interest income was mainly the result of decreased average interest rates and average transaction volumes during the fiscal year.

(b) Noninterest Income (Loss)

Noninterest income increased by approximately $7.1 million, from $(2.4) million loss in fiscal year 2009 to $4.7 million income in 2010. This increase was mainly due to an increase in the net realized and unrealized gains on investments of $7 million.

The increase in the net realized and unrealized gains on investment results from the combined effect of a $7.2 million increase in net unrealized gains of investment securities, a $2.7 million increase in the value of venture capital investments and a $2.9 million increase in net realized losses from the disposition of investments.

(c) Provision for Loan Losses

Compared to 2009, the provision for loan losses shows a decrease of $10.2 million. Although the provision for 2010 is still relatively high when compared to historical levels, this year's decrease when compared to 2009 suggest possible stabilization on the commercial lending delinquency resulting from the deterioration of the local economy and the disruptions in the financial markets experienced since the beginning of the fiscal year ended June 30, 2009. Impaired loans requiring an allowance for losses decreased by $17.5 million, from $55.6 million in 2009 to $38.1 million in 2010, and the specific reserve for these decreased by $7.2 million, from $21.9 million to $14.7 million. As a percentage of the total loans portfolio, impaired loans represent 28.9% and 31.4% at June 30, 2010 and 2009, respectively. Loans charged off during fiscal year 2010 increased by $14.7 million when compared to 2009, from $8.6 million in 2009 to $23.3 million in 2010. The increase in loans charged off is associated to the provision for loan losses of 2009, which amounted to $23.7 million, and to changes made during 2010 in the policies to charge off loans (note 1 (e)). As a percentage of the total loans portfolio, the allowance for loan losses represents 15.5% and 18.3% at June 30, 2010 and 2009, respectively.

Loan collections decreased from $68.2 million during fiscal year 2009 to $67.3 million for fiscal year 2010.

(d) Interest Expense

Total interest expense decreased by 41.1% or $18.6 million, from $45.4 million in 2009 to $26.8 million in 2010. This decrease in interest expense was the result of decreased average principal balances owed.

(e) Noninterest Expenses

Noninterest expenses decreased by approximately $1.1 million or 8.2% during fiscal year 2010. This decrease in noninterest expenses resulted from the net effect of the following:

- Salaries and employee benefits decreased by 9.4% or $866,000, from approximately $9.2 million in 2009 to approximately $8.4 million in 2010. The decrease is mainly due to a reduction in headcount.
- Professional fees decreased by 36% or $222,000, from approximately $616,000 in 2009 to approximately $394,000 in 2010. The decrease is mainly due to a decrease in temporary services and in other professional services during 2010.
- Advertising expense increased by 84.4% or $144,000, from approximately $171,000 in 2009 to approximately $315,000 in 2010. The increase is mainly due to new initiatives designed to promote economic development.
- All other noninterest expenses decreased by approximately $113,000 as compared to fiscal year 2009. This is mainly the result of the net effect of an increase of approximately $50,000 in the provision for legal claims, a decrease of $12,000 in occupancy and related expense (including depreciation), and a decrease of approximately $151,000 in other miscellaneous expenses.

Comparison of 2009 and 2008 Assets, Liabilities, and Net Assets

Condensed financial information on assets, liabilities, and net assets is presented below (dollar amounts in thousands):

				Increase (decrease)	
Net assets		**2009**	**2008**	**Amount**	**Percentage**
Current assets	$	232,356	326,658	(94,302)	(28.87)%
Noncurrent assets		728,201	985,829	(257,628)	(26.13)
Total assets	$	960,557	1,312,487	(351,930)	(26.81)
Current liabilities	$	435,815	449,521	(13,706)	(3.05)
Noncurrent liabilities		411,682	733,888	(322,206)	(43.90)
Total liabilities		847,497	1,183,409	(335,912)	(28.39)
Net assets:					
Invested in capital assets, net of related debt		(1,241)	(1,390)	(149)	(10.72)
Restricted for special loan programs		9,227	9,266	(39)	(0.42)
Unrestricted		105,074	121,202	(16,128)	(13.31)
		113,060	129,078	(16,316)	(12.64)
Total liabilities and net assets	$	960,557	1,312,487	(352,228)	(26.84)

At June 30, 2009, the Bank's total assets were $960.6 million ($307.9 million from EDBCI) compared to $1,312.5 million at June 30, 2008. The decrease of $351.9 million represents 26.8% of the 2008 total assets balance.

Total loan portfolio increased by 13% when compared to balances as of June 30, 2008. The main reason for this growth was the continued strategic effort by management to increase lending through direct loans, new loan programs, and participations with the commercial banking industry. Loan disbursements increased from $104.1 million in 2008 to $107.1 million in 2009, while principal collected on loans decreased from $72.1 million during fiscal year 2008 to $68.2 million for fiscal year 2009. The related allowance for loan losses increased by $15.7 million or 49.2% of the 2008 balance, mainly due to an increased delinquency resulting from the negative economic conditions experienced during the period. The net loan portfolio increased by $14.4 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell decreased by $356.8 million when compared to balances as of June 30, 2008, mainly due to the maturity of $322 million in promissory notes issued.

At June 30, 2009, the Bank's total liabilities were $847.5 million compared to $1,183.4 million at June 30, 2008. The decrease of $335.9 million represents 28.4% of the 2008 total liabilities. This decrease is mainly due to a $322 million decrease in promissory notes.

Total time deposits were $351.7 million as of June 30, 2009. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $245.8 million. Deposits from other financial institutions were $106 million. Total time deposits decreased by $25.7 million. As of year-end, the total promissory notes and other note payable balance was $304.2 million.

Securities sold under agreement to repurchase increased by $20.1 million, from $164.4 million in 2008 to $184.5 million in 2009. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.

The Bank had net assets of $113.1 million at June 30, 2009, a decrease of $16 million or 12.4% when compared to June 30, 2008. Additional information about net assets composition is presented in note 11 to the basic financial statements.

Comparison of 2009 and 2008 Revenue, Expenses, and Changes in Net Assets

Condensed financial information on revenue, expenses, and changes in net assets is presented below (in thousands):

Revenue, expenses, and changes in net assets	2009	2008	Increase (decrease) Amount	Increase (decrease) Percentage
Interest income from loans	$ 10,320	13,718	(3,398)	(24.77)%
Interest income from investments	58,002	62,500	(4,498)	(7.20)
Total interest income	68,322	76,218	(7,896)	(10.36)
Total noninterest income (loss)	(2,418)	1,163	(3,581)	(307.91)
Total operating revenue	65,904	77,381	(11,477)	(14.83)
Provision for loan losses	23,675	1,700	21,975	1,292.65
Total interest expense	45,361	57,703	(12,342)	(21.39)
Total noninterest expenses	12,886	12,837	49	0.38
Total operating expenses	81,922	72,240	9,682	13.40
Operating income and change in net assets	$ (16,018)	5,141	(21,159)	(411.57)

For the year ended June 30, 2009, the Bank presents an operating loss of $16 million when compared to the operating income of $5.1 million for the year ended June 30, 2008. The decrease in operating income resulted from the net effect of the following:

(a) Interest Income

Total interest income decreased by approximately 10.4% or $7.9 million, from $76.2 million in 2008 to $68.3 million in 2009. This decrease in interest income was mainly the result of decreased transaction volumes during the fiscal year.

(b) Noninterest Income (Loss)

Noninterest income decreased by approximately $3.6 million, from $1.2 million income in fiscal year 2008 to $(2.4) million loss in 2009. This decrease was due to a decrease in the net realized and unrealized gains on investment of $2.6 million and a decrease in other income of $1 million.

The decrease in the net realized and unrealized gains on investment results from the combined effect of a $2.4 million increase in unrealized losses of investment securities, a $115 thousand increase in the allowance for venture capital investments, and a $24 thousand decrease in the gain from sale of investments. The decrease in other income results mainly from a $512 thousand decrease in recoveries from loans acquired by the Bank from the former Farm Credit Guarantee Fund and the Guaranteed Loan Fund for Eligible Business previously charged off, and a $348 thousand decrease in gains from the sale of foreclosed real estate.

(Continued)

(c) Provision for Loan Losses

Compared to the 2008 figures, the provision for loan losses shows an increase of $22 million. This change is mainly due to the significant deterioration of the local economy and the disruptions in the financial markets with its effects on the commercial lending since the beginning of the fiscal year ended June 30, 2009. Impaired loans requiring an allowance for losses increased by $9.4 million, from $46.2 million in 2008 to $55.6 million in 2009, and the specific reserve for these increased by $5.8 million, from $16.1 million to $21.9 million. As a percentage of the total loans portfolio, impaired loans represent 31.4% and 28.4% at June 30, 2009 and 2008, respectively. Loans charged off during fiscal year 2009 increased by $3.6 million when compared to 2008, from $5 million in 2008 to $8.6 million in 2009.

Loan collections decreased from $72.1 million during fiscal year 2008 to $68.2 million for fiscal year 2009. As a percentage of the total loans portfolio, the allowance for loan losses represents 18.3% and 13.9% at June 30, 2009 and 2008, respectively.

(d) Interest Expense

Total interest expense decreased by 21.4% or $12.3 million, from $57.7 million in 2008 to $45.4 million in 2009. This decrease in interest expense was the result of decreased transaction volumes.

(e) Noninterest Expenses

Noninterest expenses increased by approximately $50,000 or 0.4% during fiscal year 2009. This increase in noninterest expenses resulted from the net effect of the following:

- Professional fees decreased by 21.2% or $165,000, from approximately $781,000 in 2008 to approximately $616,000 in 2009. The decrease is mainly due to a decrease in temporary services and in legal professional services during 2009.
- Advertising expense decreased by 63.9% or $303,000, from approximately $474,000 in 2008 to approximately $171,000 in 2009.
- All other noninterest expenses increased by approximately $529,000 as compared to fiscal year 2008. This is mainly the result of the net effect of an increase of approximately $550,000 in the provision for legal claims, an increase in salaries and employee benefits of approximately $268,000, a decrease of $73,000 in occupancy and related expense (including depreciation), and a decrease of approximately $229,000 in other miscellaneous expenses.

Analysis of the Overall Financial Position and Results of Operations

On the financial position, the average balance of funds available from deposits and the related investments reflect an increase when comparing 2010 to 2009, mainly due to the issuance of $176.5 million in promissory notes. Time deposits balances from other governmental and financial institutions remained at similar levels during the last two years, providing adequate levels of funding to maintain the Bank's activities.

On the other hand, the decrease in interest rates during fiscal years 2010 and 2009 had an effect in the interest income from loans, but could not prevent an increase in interest income from loans in 2010, when compared to 2009, due to increased volumes of average principal outstanding.

During the fiscal years 2010 and 2009, $2.4 million were recovered in previously charged off loans.

Discussion of Significant Capital Assets and Long-Term Debt Activity

During fiscal year 2010, approximately $42,000 in capital assets was acquired and approximately $231,000 was retired. During the same period, $181 million in promissory notes were issued, and $18 million matured or amortized. As of year-end, the total promissory notes and other note payable balance was $467.1 million. Additional information about capital assets and long-term debt activity is presented in notes 5 and 9 to the basic financial statements, respectively.

Contacting the Bank's Financial Management

This financial report is designed to provide a general overview of the Bank's finances for those interested. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Economic Development Bank for Puerto Rico, P.O. Box 2134, San Juan, PR 00922-2134.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Assets – Business-Type Activities

June 30, 2010

Assets		EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Current assets:					
Cash and due from banks	$	3,581,671	—	—	3,581,671
Interest-bearing deposits and commercial paper		—	1,615,832	(1,615,832)	—
Securities purchased under agreements to resell		167,655,000	—	—	167,655,000
Investments		10,000,000	—	—	10,000,000
Loans, net of allowance for loan losses of $13,040,513		80,833,215	—	—	80,833,215
Accrued interest receivable		4,559,072	523,641	(378)	5,082,335
Due from other fund		1,873,384	—	(1,873,384)	—
		268,502,342	2,139,473	(3,489,594)	267,152,221
Noncurrent assets:					
Investments		463,939,953	312,252,394	—	776,192,347
Loans, net of allowance for loan losses of $26,533,414		134,852,048	—	—	134,852,048
Other assets		7,477,746	—	—	7,477,746
Capital assets:					
Building and improvements		13,707,634	—	—	13,707,634
Furniture and equipment		5,071,030	—	—	5,071,030
Less accumulated depreciation and amortization		(9,261,984)	—	—	(9,261,984)
Total capital assets		9,516,680	—	—	9,516,680
		615,786,427	312,252,394	—	928,038,821
Total assets	$	884,288,769	314,391,867	(3,489,594)	1,195,191,042
Liabilities and Net Assets					
Current liabilities:					
Time deposits	$	386,894,344	—	(1,615,832)	385,278,512
Securities sold under agreements to repurchase		63,450,000	—	—	63,450,000
Accrued interest payable		1,989,229	473,611	(378)	2,462,462
Promissory notes and other note payable		418,958	—	—	418,958
Due to other fund		—	1,873,384	(1,873,384)	—
Other current liabilities		4,288,169	12,828	—	4,300,997
		457,040,700	2,359,823	(3,489,594)	455,910,929
Noncurrent liabilities:					
Securities sold under agreements to repurchase		114,300,000	—	—	114,300,000
Promissory notes and other note payable		191,657,556	275,000,000	—	466,657,556
Other liabilities		13,330,910	12,349	—	13,343,259
		319,288,466	275,012,349	—	594,300,815
Total liabilities		776,329,166	277,372,172	(3,489,594)	1,050,211,744
Net assets:					
Invested in capital assets, net of related debt		(1,239,019)	—	—	(1,239,019)
Restricted for special loan programs		8,889,365	—	—	8,889,365
Unrestricted		100,309,257	37,019,695	—	137,328,952
Total net assets		107,959,603	37,019,695	—	144,979,298
Commitments and contingencies					
Total liabilities and net assets	$	884,288,769	314,391,867	(3,489,594)	1,195,191,042

See accompanying notes to basic financial statements.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue, Expenses, and Changes in Net Assets – Business-Type Activities

Year ended June 30, 2010

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Operating revenue:				
Interest income:				
Deposits with other banks and commercial paper	$ 159,098	1,488	(1,488)	159,098
Securities purchased under agreements to resell	1,197,088	—	—	1,197,088
Investments	17,428,683	18,837,500	—	36,266,183
Loans	11,673,495	—	—	11,673,495
Total interest income	30,458,364	18,838,988	(1,488)	49,295,864
Noninterest income:				
Net realized and unrealized gains on investments	494,023	3,070,571	—	3,564,594
Other income	1,176,620	—	(61,870)	1,114,750
Total noninterest income	1,670,643	3,070,571	(61,870)	4,679,344
Total operating revenue	32,129,007	21,909,559	(63,358)	53,975,208
Operating expenses:				
Provision for loan losses	13,485,000	—	—	13,485,000
Interest expense:				
Time deposits	2,524,908	—	(1,488)	2,523,420
Securities sold under agreements to repurchase	4,308,157	—	—	4,308,157
Promissory notes and other note payable	2,859,386	17,050,000	—	19,909,386
Total interest expense	9,692,451	17,050,000	(1,488)	26,740,963
Noninterest expenses:				
Salaries and employee benefits	8,289,062	92,629	—	8,381,691
Depreciation and amortization	426,797	—	—	426,797
Occupancy and related expenses	346,898	—	—	346,898
Professional fees	393,890	61,870	(61,870)	393,890
Advertising	315,356	—	—	315,356
Other	1,964,853	737	—	1,965,590
Total noninterest expenses	11,736,856	155,236	(61,870)	11,830,222
Total operating expenses	34,914,307	17,205,236	(63,358)	52,056,185
Operating income (loss)	(2,785,300)	4,704,323	—	1,919,023
Capital contribution	30,000,000	—	—	30,000,000
Increase in net assets	27,214,700	4,704,323	—	31,919,023
Total net assets, beginning of year	80,744,903	32,315,372	—	113,060,275
Total net assets, end of year	$ 107,959,603	37,019,695	—	144,979,298

See accompanying notes to basic financial statements.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2010

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Cash flows from operating activities:				
Cash payments for goods and services	$ (2,036,902)	(62,607)	—	(2,099,509)
Cash payments to employees	(8,439,366)	(87,624)	—	(8,526,990)
Cash received from interest and principal on loans	78,551,068	—	—	78,551,068
Other receipts	9,097,208	1,766,777	—	10,863,985
Cash disbursed for loaned amounts	(85,148,414)	—	—	(85,148,414)
Net cash provided by (used in) operating activities	(7,976,406)	1,616,546	—	(6,359,860)
Cash flows from noncapital financing activities:				
Net increase (decrease) in:				
Time deposits	35,093,467	—	(1,538,256)	33,555,211
Securities sold under agreements to repurchase	(6,735,000)	—	—	(6,735,000)
Issuance of promissory notes	181,320,815	—	—	181,320,815
Repayment of promissory notes	(18,000,000)	—	—	(18,000,000)
Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes	(7,840,021)	(17,050,000)	1,112	(24,888,909)
Net cash provided by (used in) noncapital financing activities	183,839,261	(17,050,000)	(1,537,144)	165,252,117
Cash flows from capital and related financing activities:				
Capital contribution	30,000,000	—	—	30,000,000
Acquisition of capital assets, net	(33,207)	—	—	(33,207)
Principal payment on capital debt	(395,243)	—	—	(395,243)
Interest paid on capital debt	(669,057)	—	—	(669,057)
Net cash provided by capital and related financing activities	28,902,493	—	—	28,902,493
Cash flows from investing activities:				
Acquisition of investments	(300,135,770)	(4,964,287)	—	(305,100,057)
Principal repayments and maturities of investments	137,934,480	3,097,385	—	141,031,865
Net decrease (increase) in:				
Interest-bearing deposits with other banks	—	(1,538,256)	1,538,256	—
Securities purchased under agreements to resell	(58,255,000)	—	—	(58,255,000)
Interest collected on investments, notes receivable interest-bearing deposits with other banks, and commercial paper	16,238,277	18,838,612	(1,112)	35,075,777
Proceeds from sales of foreclosed assets	527,062	—	—	527,062
Net cash provided by (used in) investing activities	(203,690,951)	15,433,454	1,537,144	(186,720,353)
Net increase in cash and due from banks	1,074,397	—	—	1,074,397
Cash and due from banks, beginning of year	2,507,274	—	—	2,507,274
Cash and due from banks, end of year	$ 3,581,671	—	—	3,581,671

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2010

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Reconciliation of operating income (loss) to net cash used in operating activities:				
Operating income (loss)	$ (2,785,300)	4,704,323	—	1,919,023
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	426,797	—	—	426,797
Net realized and unrealized gains on investments	(494,023)	(3,070,571)	—	(3,564,594)
Provision for loan losses	13,485,000	—	—	13,485,000
Provision for losses on foreclosed assets	300,000	—	—	300,000
Gain on sale of foreclosed assets	(218,440)	—	—	(218,440)
Interest income from investments	(18,784,869)	(18,838,988)	1,488	(37,622,369)
Decrease in accrued interest receivable from loans	222,101	—	—	222,101
Interest expense	9,692,451	17,050,000	(1,488)	26,740,963
Decrease (increase) in other assets	(3,108,035)	1,766,777	—	(1,341,258)
Increase in loans receivable	(18,492,942)	—	—	(18,492,942)
Increase in other liabilities	11,780,854	5,005	—	11,785,859
Net cash provided by (used in) operating activities	$ (7,976,406)	1,616,546	—	(6,359,860)
Supplemental cash flow information and noncash transactions:				
Increase in fair value of investments	$ 3,396,114	3,070,571	—	6,466,685
Transfer from loans to foreclosed real estate	2,375,204	—	—	2,375,204
Retirement of fully depreciated capital assets	178,656	—	—	178,656

See accompanying notes to basic financial statements.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Assets – Business-Type Activities

June 30, 2009

Assets		**EDB Operating Fund**	**EDB Capital Investment**	**Eliminations**	**Total**
Current assets:					
Cash and due from banks	$	2,507,274	—	—	2,507,274
Interest-bearing deposits and commercial paper		—	77,576	(77,576)	—
Securities purchased under agreements to resell		109,400,000	—	—	109,400,000
Investments		51,675,258	—	—	51,675,258
Loans, net of allowance for loan losses of $16,342,269		66,015,394	—	—	66,015,394
Accrued interest receivable		2,234,582	523,266	(2)	2,757,846
Due from other fund		106,607	—	(106,607)	—
		231,939,115	600,842	(184,185)	232,355,772
Noncurrent assets:					
Investments		259,569,382	307,314,921	—	566,884,303
Loans, net of allowance for loan losses of $31,314,476		147,037,131	—	—	147,037,131
Other assets		4,369,906	—	—	4,369,906
Capital assets:					
Building and improvements		13,687,838	—	—	13,687,838
Furniture and equipment		5,307,186	—	—	5,307,186
Less accumulated depreciation and amortization		(9,084,755)	—	—	(9,084,755)
Total capital assets		9,910,269	—	—	9,910,269
		420,886,688	307,314,921	—	728,201,609
Total assets	$	652,825,803	307,915,763	(184,185)	960,557,381
Liabilities and Net Assets					
Current liabilities:					
Time deposits	$	351,800,877	—	(77,576)	351,723,301
Securities sold under agreements to repurchase		79,685,000	—	—	79,685,000
Accrued interest payable		805,856	473,611	(2)	1,279,465
Promissory notes and other note payable		395,243	—	—	395,243
Due to other fund		—	106,607	(106,607)	—
Other current liabilities		2,726,397	5,456	—	2,731,853
		435,413,373	585,674	(184,185)	435,814,862
Noncurrent liabilities:					
Securities sold under agreements to repurchase		104,800,000	—	—	104,800,000
Promissory notes and other note payable		28,755,699	275,000,000	—	303,755,699
Other liabilities		3,111,828	14,717	—	3,126,545
		136,667,527	275,014,717	—	411,682,244
Total liabilities		572,080,900	275,600,391	(184,185)	847,497,106
Net assets:					
Invested in capital assets, net of related debt		(1,240,673)	—	—	(1,240,673)
Restricted for special loan programs		9,227,191	—	—	9,227,191
Unrestricted		72,758,385	32,315,372	—	105,073,757
Total net assets		80,744,903	32,315,372	—	113,060,275
Commitments and contingencies					
Total liabilities and net assets	$	652,825,803	307,915,763	(184,185)	960,557,381

See accompanying notes to basic financial statements.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue, Expenses, and Changes in Net Assets – Business-Type Activities

Year ended June 30, 2009

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Operating revenue:				
Interest income:				
Deposits with other banks and commercial paper	$ 2,959,282	11,951	(11,951)	2,959,282
Securities purchased under agreements to resell	63,775	—	—	63,775
Investments	36,141,132	18,837,500	—	54,978,632
Loans	10,320,165	—	—	10,320,165
Total interest income	49,484,354	18,849,451	(11,951)	68,321,854
Noninterest income (loss):				
Net realized and unrealized gains (losses) on investments	(3,786,798)	320,593	—	(3,466,205)
Other income	1,109,779	—	(61,253)	1,048,526
Total noninterest income (loss)	(2,677,019)	320,593	(61,253)	(2,417,679)
Total operating revenue	46,807,335	19,170,044	(73,204)	65,904,175
Operating expenses:				
Provision for loan losses	23,675,000	—	—	23,675,000
Interest expense:				
Time deposits	8,303,096	—	(11,951)	8,291,145
Securities sold under agreements to repurchase	4,868,461	—	—	4,868,461
Promissory notes and other note payable	15,151,149	17,050,000	—	32,201,149
Total interest expense	28,322,706	17,050,000	(11,951)	45,360,755
Noninterest expenses:				
Salaries and employee benefits	9,137,084	110,210	—	9,247,294
Depreciation and amortization	515,605	—	—	515,605
Occupancy and related expenses	269,827	—	—	269,827
Professional fees	615,709	61,253	(61,253)	615,709
Advertising	171,059	—	—	171,059
Other	2,062,070	4,763	—	2,066,833
Total noninterest expenses	12,771,354	176,226	(61,253)	12,886,327
Total operating expenses	64,769,060	17,226,226	(73,204)	81,922,082
Operating income (loss) and change in net assets	(17,961,725)	1,943,818	—	(16,017,907)
Total net assets, beginning of year	98,706,628	30,371,554	—	129,078,182
Total net assets, end of year	$ 80,744,903	32,315,372	—	113,060,275

See accompanying notes to basic financial statements.

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2009

		EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Cash flows from operating activities:					
Cash payments for goods and services	$	(2,758,752)	(66,015)	—	(2,824,767)
Cash payments to employees		(9,395,796)	(95,411)	—	(9,491,207)
Cash received from interest and principal on loans		79,437,569	—	—	79,437,569
Other receipts (payments)		2,097,365	(2,779,552)	—	(682,187)
Cash disbursed for loaned amounts		(107,101,348)	—	—	(107,101,348)
Net cash used in operating activities		(37,720,962)	(2,940,978)	—	(40,661,940)
Cash flows from noncapital financing activities:					
Net increase (decrease) in:					
Time deposits		(26,543,351)	—	812,599	(25,730,752)
Securities sold under agreements to repurchase		20,057,000	—	—	20,057,000
Repayment of promissory notes		(322,000,000)	—	—	(322,000,000)
Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes		(34,861,764)	(17,050,000)	12,430	(51,899,334)
Net cash used in noncapital financing activities		(363,348,115)	(17,050,000)	825,029	(379,573,086)
Cash flows from capital and related financing activities:					
Acquisition of capital assets		(292,261)	—	—	(292,261)
Principal payment on capital debt		(372,872)	—	—	(372,872)
Interest paid on capital debt		691,429	—	—	691,429
Net cash provided by capital and related financing activities		26,296	—	—	26,296
Cash flows from investing activities:					
Acquisition of investments		(401,090,918)	(5,392,647)	—	(406,483,565)
Principal repayments and maturities of investments		721,652,094	5,721,096	—	727,373,190
Net decrease (increase) in:					
Interest-bearing deposits with other banks		141,850,000	812,599	(812,599)	141,850,000
Securities purchased under agreements to resell		(109,400,000)	—	—	(109,400,000)
Interest collected on investments, notes receivable interest-bearing deposits with other banks, and commercial paper		45,557,295	18,849,930	(12,430)	64,394,795
Proceeds from sales of foreclosed assets		314,850	—	—	314,850
Net cash provided by investing activities		398,883,321	19,990,978	(825,029)	418,049,270
Net decrease in cash and due from banks		(2,159,460)	—	—	(2,159,460)
Cash and due from banks, beginning of year		4,666,734	—	—	4,666,734
Cash and due from banks, end of year	$	2,507,274	—	—	2,507,274

(Continued)

ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2009

		EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Reconciliation of operating income (loss) to net cash used in operating activities:					
Operating income (loss)	$	(17,961,725)	1,943,818	—	(16,017,907)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:					
Depreciation and amortization		515,605	—	—	515,605
Net realized and unrealized losses (gains) on investments		3,786,798	(320,593)	—	3,466,205
Provision for loan losses		23,675,000	—	—	23,675,000
Provision for losses on foreclosed assets		300,000	—	—	300,000
Loss on sale of foreclosed assets		6,750	—	—	6,750
Interest income from investments		(39,164,189)	(18,849,451)	11,951	(58,001,689)
Increase in accrued interest receivable from loans		387,825	—	—	387,825
Interest expense		28,322,706	17,050,000	(11,951)	45,360,755
Decrease (increase) in other assets		597,570	(2,779,552)	—	(2,181,982)
Increase in loans receivable		(38,371,769)	—	—	(38,371,769)
Increase in other liabilities		184,467	14,800	—	199,267
Net cash used in operating activities	$	(37,720,962)	(2,940,978)	—	(40,661,940)
Supplemental cash flow information and noncash transactions:					
Increase (decrease) in fair value of investments	$	(3,786,798)	320,593	—	(3,466,205)
Transfer from loans to foreclosed real estate		651,812	—	—	651,812
Retirement of fully depreciated capital assets		429,573	—	—	429,573

See accompanying notes to basic financial statements.

(1) Organization and Summary of Significant Accounting Policies

Economic Development Bank for Puerto Rico (the Bank) was created by the Puerto Rico Development Bank Act No. 22 of July 24, 1985, as amended, and constitutes a public corporation of the Commonwealth of Puerto Rico (the Commonwealth). The Bank is a component unit included in the Commonwealth's financial reporting entity and is a separate legal entity. The Bank promotes the development of the private sector of the economy of Puerto Rico. This is accomplished by making direct loans, loan guarantees, loan participations, and/or direct investments available to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises, whose economic activity may have the effect of substituting imports, without this being understood as a limitation.

The Bank's operation consists principally in granting commercial loans and capital investments to small businesses, receiving deposits from other governmental or commercial financial institutions, issuing notes and other debts, and investing in securities and other financial instruments, similar to a private commercial bank. All revenue, such as interest, gains, dividends, and fees related to these activities, are presented as operating income. All expenses related to these revenue activities, such as interest expense, provision for losses, and administrative expenses, are considered operating expenses. For financial statements presentation, operating revenue is segregated between interest income and noninterest income, and operating expenses between interest expense, provision for losses, and other noninterest expenses.

The Bank is not required to pay any taxes on any assets acquired or to be acquired for its operations or activities, or on the revenue received from any of its operations or activities.

In 2006, the Bank's board of directors created a component unit named Economic Development Bank Capital Investment (EDBCI). EDBCI is a blended component unit of the Bank, which is presented as a business-type activity. The balances and transactions of EDBCI have been blended with the Bank in accordance with U.S. generally accepted accounting principles (GAAP) because, though legally separated, it was created and can be dissolved through resolutions of the Bank's board of directors. The board of directors of EDBCI is the same as that of the Bank. EDBCI operation consists only of supporting the Bank's mission in promoting the development of the private sector of the economy of Puerto Rico, investing in equity and other forms of capital of start-up, early, or later stage local enterprises or venture capital funds. During fiscal year 2007, the Bank transferred its capital investment portfolio, amounting to $27,445,966, as initial capital to EDBCI. An additional $30 million were approved for new capital investments as deemed necessary in EDBCI investment activity. Also, EDBCI was authorized to invest in corporate paper as part of a new notes payable program like the one described in note 9.

The accounting policies followed by the Bank are in accordance with GAAP, as applicable to governmental entities. The business-type activities of the Bank are accounted for as an enterprise fund. Accordingly, the Bank follows the accrual basis of accounting and the economic resources measurement focus. Revenue is recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid. The following is a description of the most significant accounting policies:

(a) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made by management include the allowance for loan losses, losses on foreclosed assets, losses on loan guarantees, and venture capital investments; the useful lives of fixed assets; the valuation of fixed assets and investments; and accruals for legal claims and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

(b) Basis of Presentation

Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Bank is required to apply all applicable GASB pronouncements as well as statements and interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions (APB), and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure issued on or before November 30, 1989. In addition to applying FASB Statements and Interpretations, APB Opinions, and ARBs issued on or before November 30, 1989, a proprietary activity may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Bank has elected to also apply FASB Statements and Interpretations issued after November 30, 1989.

(c) Securities Purchased under Agreements to Resell

The Bank enters into purchases of securities under agreements to resell, as authorized by Act number 22 of July 24, 1985, Article 3. The amounts advanced under these agreements are reflected as an asset in the accompanying statements of net assets. The securities underlying these agreements, mainly interest-bearing deposits with other banks and government securities, are held under safekeeping by a financial institution independent of the transaction.

(d) Investments

The Bank follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This Statement establishes accounting and financial reporting standards for all investments held by governmental external investment pools. For most other governmental entities, it requires that most investments be reported at fair value in the statements of net assets.

The governing board authorizes the Bank to invest in the following:

- U.S. government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations, and instrumentalities
- Certificates and time deposits
- Commercial paper
- Bankers' acceptance
- Federal funds
- Securities purchased under agreements to resell
- Mortgage- and asset-backed securities
- Corporate notes
- External investment pools

The Bank's investment policies also establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories. Such policies provide the requirements in the institutions with which investment transactions can be entered into. In addition, the assets, liabilities, and investments, Committee and the board of directors of the Bank may approve, as necessary, other transactions that the Bank may enter into.

Investments in debt securities are presented at fair value, including the effect of applicable put options as described in note 9. Money market investments and participating interest-earning investment contracts with a remaining maturity at time of purchase of one year or less are presented at amortized cost. Changes in the fair value of investments are presented in net realized and unrealized gains (losses) on investments in the statements of revenue, expenses, and changes in net assets. Fair value is determined based on quoted market prices.

Investments also include common and preferred stocks of various local enterprises that do not have readily determinable fair value and investment positions in external investment pools. The investments in common and preferred stocks are temporary and the Bank generally does not have the ability to exercise significant influence over the investees' operating and financial policies, and therefore, such investments are carried at the lower of cost or net realizable value based on management's evaluation of the financial condition of each investee. Because of uncertainties inherent in the estimation process, management's evaluation of the financial condition of the investees, and the related assessment of net realizable value may change in the near term.

(Continued)

Investment positions in external investment pools are reported at the net asset value of the shares held by the Bank. Such net asset value represents the fair value per share of the pools' underlying net assets. The financial statements of these pools include securities whose fair values have been estimated by the pools' managers in the absence of readily ascertainable market values. The Bank's external investment pools that are not registered with the Securities and Exchange Commission are supervised by the Commissioner of Financial Institutions, which is the governmental agency that regulates venture capital funds and the banking industry in Puerto Rico.

(e) Loans

Loans are presented at the unpaid principal balance reduced by the allowance for loan losses, and any deferred fees or costs on originated loans. In accordance with the Bank's charge-off policy approved on May 2010, unsecured loans are charged off against the allowance for loans losses once they have payments due over 120 days. For collateralized loans, charge-offs are recognized for the amount of collateral deficiency once they have payments due over 180 days. Although one of the factors evaluated by management in making this assessment is the number of days past due, the policy also allows the Bank's to charge-off loans when special circumstances arise and upon the approval of the corresponding level of authority.

Recoveries of loans previously charged off are credited to the allowance for loan losses.

The accrual of interest on loans ceases when loans become past due 90 days or more and/or on those loans undergoing judicial or bankruptcy proceedings. Once a loan is placed on nonaccrual status, all accrued but uncollected interest is reversed from interest income. Interest on all nonaccrual loans is thereafter included in earnings only to the extent actually collected. Loans designated as nonaccruing are not returned to an accrual status until interest is received on a current basis and those factors indicative of doubtful collection cease to exist.

The allowance for loan losses is maintained at a level believed adequate by management to absorb potential losses in the loan portfolio. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, past loan loss experience, economic conditions, volume growth, composition of the loan portfolio, and other relevant factors. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio, and the related allowance may change in the near term.

(f) Classification of Loans and Allowance for Loan Losses

The current portion of loans includes the active principal of loans with maturities of one year or less and past due over three months and/or those loans undergoing judicial or bankruptcy proceedings. Also, these include the estimated current portion of loans with maturity over one year. The resulting difference was reported as the noncurrent portion.

The allowance for loan losses was allocated similarly between current and noncurrent portion based on the loan classification.

(g) Loan Guarantee Program

Guarantee fees on the loan guarantee program are recognized as income when the fees are collected. Such fees are estimated not to exceed related guarantee expenses. The accrual for losses on loan guarantees is based on management's evaluation of the potential loss on each guarantee, net of amounts recoverable from collateral and the share of loss of the participating banks, and is included in other liabilities. Because of uncertainties inherent in the estimation process, management's estimate of the provision for losses on loan guarantees, and the related accrual for losses on loan guarantees may change in the near term.

(h) Loan Origination Costs and Commitment Fees

The Bank defers loan origination and commitment fees and direct origination costs. The net amount is amortized over the contractual life of the related loan as a yield adjustment.

(i) Real Estate Owned

Real estate owned acquired in satisfaction of loans is included in other assets and is held for sale. Properties acquired through foreclosure are transferred to real estate owned and recognized at the lower of fair value minus estimated costs to sell or loan's carrying value, establishing a new cost basis. Subsequent declines in the value of real estate owned are provided for when it is probable the cost will not be recovered and that a loss will be incurred. An allowance for losses on real estate owned is maintained for subsequent valuation adjustments on a specific property basis.

(j) Capital Assets

Capital assets are defined by the Bank as assets with an individual initial cost of over $500 and expected useful lives of over one year. Capital assets are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on the straight-line basis over the estimated useful lives of the depreciable assets, which have been determined to be 3 years for computer software, 5 years for all furniture and equipment, and 40 years for building and improvements. Expenditures for major improvements that extend the useful life of the asset are capitalized. Maintenance and repairs are charged to expense.

(k) Securities Sold under Agreements to Repurchase

The Bank enters into sales of securities under agreements to repurchase, as authorized by Act number 22 of July 24, 1985, Article 3. These agreements are presented as a liability in the accompanying statements of net assets. The securities underlying these agreements are usually held by the broker or its agent, with whom the agreement is transacted.

(l) Accounting for Compensated Absences

Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the statement of net assets date. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences.

(m) Statements of Cash Flows

The accompanying statements of cash flows are presented in accordance with the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. For purposes of reporting cash flows, cash includes cash on hand, amounts due from banks, and items in process of collection.

(2) Cash and Due from Banks, Interest-Bearing Deposits with Other Banks and Commercial Paper, and Securities Purchased under Agreements to Resell

As of June 30, 2010 and 2009, the carrying amount and the corresponding depository bank balances of cash and due from banks and interest-bearing deposits with other banks were as follows:

		2010	
		Carrying amount	**Depository bank balance**
Cash and due from banks	$	3,581,671	4,280,624

		2009	
		Carrying amount	**Depository bank balance**
Cash and due from banks	$	2,507,274	4,937,245

As of June 30, 2010 and 2009, the total depository bank balance consisted of $3,387,422 and $3,304,889, respectively, which was insured or collateralized with securities held by the Department of the Treasury of the Commonwealth and $893,202 and $1,632,356, respectively, deposited with the Government Development Bank for Puerto Rico (GDB), another component unit of the Commonwealth. Deposits with GDB are uninsured and uncollateralized.

The Bank's investment policies allow management to purchase commercial paper. The following table summarizes certain information about these purchases for the year ended June 30, 2009 (none in 2010):

Carrying amount at June 30	$	—
Average amount outstanding during the year		51,294,000
Maximum amount outstanding at any month-end		106,358,000
Weighted average interest rate for the year		2.67%

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to purchase securities under agreements to resell. The following table summarizes certain information about these agreements:

		2010	2009
Carrying amount at June 30	$	167,655,000	109,400,000
Average amount outstanding during the year		158,801,000	13,967,000
Maximum amount outstanding at any month-end		185,240,000	109,400,000
Weighted average interest rate for the year		0.76%	0.76%
Weighted average interest rate at year-end		0.73	0.78
Weighted average maturity (years)		0.05	0.04

The Bank's investment policies establish the minimum amount of acceptable collateral. The market prices of the collateral are revised monthly and the margin amount adjusted accordingly. The aggregate market value of the securities underlying the agreements outstanding at June 30, 2010 and 2009 were $179,391,000 and $118,966,000, respectively.

(3) Investments

As of June 30, 2010 and 2009, the Bank had the following investments:

		2010	
Investment type		**Fair value**	**Weighted average maturity (years)**
Federal Home Loan Bank – MBS	$	27,609,420	2.4
Federal National Mortgage Association – MBS		6,000,000	0.8
Municipal bonds		13,228,971	21.5
Municipal bonds – notes payable program		181,345,775	See below
Corporate paper		73,875,000	1.2
Corporate paper – notes payable program		275,000,000	See below
Collateralized mortgage obligations		171,880,787	2.3
External investment pools		34,358,269	N/A
Equity investments		2,894,125	N/A
Total fair value	$	786,192,347	

		2009	
Investment type		**Fair value**	**Weighted average maturity (years)**
Federal Home Loan Bank – MBS	$	10,118,223	2.9
Federal National Mortgage Association – MBS		14,955,000	3.9
Federal Farm Credit Bank – MBS		3,201,557	0.2
Federal National Mortgage Association – notes payable program		18,000,000	See below
Corporate paper		74,062,500	2.2
Corporate paper – notes payable program		275,000,000	See below
Collateralized mortgage obligations		190,907,360	1.6
External investment pools		27,737,759	N/A
Equity investments		4,577,162	N/A
Total fair value	$	618,559,561	

Interest rate risk – In accordance with its investment policy, the Bank manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio generally to less than three years.

Those investments related to the notes payable programs involve matched transactions that generate a fixed spread of income to the Bank. These were directly approved by the Bank's board of directors and are not subject to the maximum maturity policy. As of June 30, 2010 and 2009, the investments related to the notes payable program have a weighted average maturity of 10.2 and 4.1 years, respectively.

In addition, investments in external investment pools and equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. These instruments are not sold on secondary markets and are not priced in any stock exchange, and as such, its fair value depends on the performance of the involved enterprises. The inherent risk in these investments is managed through credit analysis, periodic reviews of results of operations, and meetings with subject companies and investment pools managers.

Credit risk – The Bank's investment policy limits long-term investment in corporate debt to the top three ratings issued by nationally recognized statistical rating organizations, and short-term investments in corporate debt to the top two ratings issued by nationally recognized statistical rating organizations.

As of June 30, 2010, the Bank's investments in corporate paper were rated B by Standard & Poor's and Ba1 by Moody's Investor Service, the Bank's investments in collateralized mortgage obligations were rated AAA, AAA/A+, BBB, BB-, or D by Standard & Poor's and AAA, AAA/F1, AAA-, A, or D by Fitch Ratings, the Bank's investment in Federal National Mortgage Association and Federal Home Loan Bank were rated AAA by Standard & Poor's and Aaa by Moody's Investor Service and the Bank's investment in municipal bonds were rated AAA or AAAe by Standard & Poor's and AAA, AA+, or Ae by Fitch Ratings.

As of June 30, 2009, the Bank's investments in corporate paper were rated BB- by Standard & Poor's and Ba1*- by Moody's Investor Service, the Bank's investments in collateralized mortgage obligations were rated AAA, AAA/A+, AAA*-, BBB+, B*-, or CCC by Standard & Poor's and AAA, AAA/F1, AAA*-, CCC, or CC by Fitch Ratings and the Bank's investment in Federal National Mortgage Association, Federal Home Loan Bank, and Federal Farm Credit Bank were rated AAA by Standard & Poor's and Aaa by Moody's Investor Service.

The Bank, through EDBCI, also invests in venture capital through external investment pools and through direct investment in equity securities. The Bank's investments in external investment pools and equity securities are not rated by a nationally recognized statistical rating organization. The related credit risk is measured through credit analysis, periodic reviews of results of operations, and meetings with subject companies' management. In addition, a reserve for possible losses in venture capital investments is recorded as a measure of providing a fair value in the financial statements. As of June 30, 2010 and 2009, the venture capital balances comprised the following:

		2010	2009
External investment pools	$	31,062,735	29,045,171
Equity investments		8,569,000	10,769,000
		39,631,735	39,814,171
Allowance for losses in venture capital investments		(2,379,341)	(7,499,250)
Fair value of venture capital investments	$	37,252,394	32,314,921

Custodial credit risk deposits – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the Bank may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2010 and 2009, securities investments were registered in the name of the Bank and were held in the possession of the Bank's custodian institution.

The Bank was exposed to the following custodial credit risk for investments held at June 30, 2010:

Uninsured and registered, with securities held by the counterparty's trust department or agent in the Bank's name	$	748,939,953
Uninsured and unregistered, with securities held by the Bank		37,252,394
Total	$	786,192,347

Concentration of credit risk – The Bank places no limit on the amount it may invest in any one issuer as a percentage of the investment portfolio. As of June 30, 2010, more than 5% of the Bank's investments are in Popular Inc. (the Issuer) corporate notes (44.4%), Municipal Bonds (24.8%), Federal National Mortgage Association REMIC CMO's (10%), and Federal Home Loan Mortgage Corporation REMIC CMO's (6.6%). As of June 30, 2009, more than 5% of the Bank's investments are in Popular Inc. (the Issuer) corporate notes (56.4%), Federal Home Loan Mortgage Corporation REMIC CMO's (12.8%), Federal National Mortgage Association REMIC CMO's (6.6%), and Federal National Mortgage Association notes (5.3%).

Proceeds from sales, principal payments, and maturities of investments, including equity investments and gross realized gains or losses, for the years ended June 30, 2010 and 2009 are as follows:

		2010	2009
Proceeds from sales	$	8,849,294	—
Proceeds from principal payments and maturities		129,932,571	727,373,190
Gross gains		272,371	—

(4) Loans and Allowance for Loan Losses

The balance of current and noncurrent loans consists of loans originated by the Bank and amounts paid under the loan guarantee program. During the years ended June 30, 2010 and 2009, the Bank has made no payments under the loan guarantee program.

Loans distribution among industry sectors as of June 30, 2010 and 2009 are as follows:

		2010	2009
Agricultural	$	41,907,067	53,679,457
Commercial		49,881,812	56,052,712
Services		111,737,981	105,614,246
Manufacturing		31,678,263	26,145,850
Tourism		20,054,067	19,217,005
Total loans		255,259,190	260,709,270
Allowance for loan losses		(39,573,927)	(47,656,745)
	$	215,685,263	213,052,525

The Bank has defined impaired loans as all loans with interest and/or principal past due 90 days or more and other loans for which, based on current information, it is probable that the debtor will be unable to pay according to the contractual terms of the loan agreement. The Bank generally measures impairment based upon the present value of a loan's expected future cash flows, except where foreclosure or liquidation is probable or when the primary source of repayment is provided by collateral. In these circumstances, impairment is measured based upon the fair value of the collateral less estimated selling and disposal costs. The present value of a loan's expected future cash flows is calculated using the loan's effective interest rate based on the original contractual terms.

Cash payments received on impaired loans are recorded in accordance with the contractual terms of the loan. The principal portion of the payments is used to reduce the principal balance of the loan; the interest portion is recognized as interest income. When management believes that collectibility of principal is doubtful, the interest portion may be applied to principal.

(Continued)

The following is a summary of information on loans considered to be impaired in accordance with ASC Subtopic 310-35-35, previously, FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, as of June 30, 2010 and 2009 and the related interest income for the years then ended:

		2010	2009
Recorded investment in impaired loans not requiring an allowance for loan losses	$	35,713,000	26,142,000
Recorded investment in impaired loans requiring an allowance for loan losses		38,056,000	55,649,000
Total recorded investment in impaired loans	$	73,769,000	81,791,000
Related valuation allowance	$	14,663,000	21,878,000
Average recorded investment in impaired loans		73,679,000	63,966,000
Interest income recognized		1,486,000	2,126,000

At June 30, 2010 and 2009, loans on which the accrual of interest has been discontinued (cash basis loans), due to delinquency over 89 days and/or due to restructurings, amounted to $126,257,755 ($42,574,736 over 89 days and $83,683,019 restructured loans) and $110,484,188 ($63,001,645 over 89 days and $47,482,543 restructured loans), respectively. The additional interest income that would have been recorded if these loans had performed in accordance with their original terms is estimated at approximately $5,151,081 and $6,830,250 as of June 30, 2010 and 2009, respectively.

Changes in the total allowance for loan losses for the years ended June 30, 2010 and 2009 were as follows:

		2010	2009
Balance, beginning of year	$	47,656,745	31,936,640
Provision charged to operations		13,485,000	23,675,000
Loans charged off as uncollectible		(23,298,330)	(8,616,160)
Recoveries		1,730,512	661,265
Balance, end of year	$	39,573,927	47,656,745

(5) Capital Assets

Capital assets activity for the years ended June 30, 2010 and 2009 was as follows:

	2010			
	Beginning balance	Increases	Decreases	Ending balance
Building and improvements	$ 13,687,838	19,796	—	13,707,634
Furniture and equipment	5,307,186	22,615	(258,771)	5,071,030
Total cost	18,995,024	42,411	(258,771)	18,778,664
Less accumulated depreciation and amortization:				
Building and improvements	(4,211,589)	(270,252)	—	(4,481,841)
Furniture and equipment	(4,873,166)	(156,545)	249,568	(4,780,143)
Total accumulated depreciation and amortization	(9,084,755)	(426,797)	249,568	(9,261,984)
Capital assets, net	$ 9,910,269	(384,386)	(9,203)	9,516,680

	2009			
	Beginning balance	Increases	Decreases	Ending balance
Building and improvements	$ 13,652,625	35,213	—	13,687,838
Furniture and equipment	5,479,711	257,048	(429,573)	5,307,186
Total cost	19,132,336	292,261	(429,573)	18,995,024
Less accumulated depreciation and amortization:				
Building and improvements	(3,920,045)	(291,544)	—	(4,211,589)
Furniture and equipment	(5,078,678)	(224,061)	429,573	(4,873,166)
Total accumulated depreciation and amortization	(8,998,723)	(515,605)	429,573	(9,084,755)
Capital assets, net	$ 10,133,613	(223,344)	—	9,910,269

The Bank’s principal premises are partially rented to various lessees under lease terms expiring at various future dates. Minimum future rentals to be received for the next two years ended June 30, 2011 and 2012 are approximately $398,000 and $262,000, respectively.

(Continued)

Rent revenue amounting to approximately $406,000 and $499,000 was recorded as other income in the accompanying 2010 and 2009 statements of revenue, expenses, and changes in net assets, respectively.

(6) Other Assets

Other assets as of June 30, 2010 and 2009 consist of the following:

		2010	2009
Other real estate owned, net of allowance for losses of $3,802,110 in 2010 and $3,747,401 in 2009	$	5,703,553	3,922,971
Deferred issuance costs		144,111	153,120
Accounts receivable from other Commonwealth component units		157,091	64,986
Other		1,472,991	228,829
Total	$	7,477,746	4,369,906

(7) Time Deposits

Time deposits consist of deposits with fixed maturity dates (not exceeding 12 months) received from other governmental institutions, commercial banks, or other financial institutions. Governmental time deposits (Commonwealth and its component units) are exempt by law from the collateral requirement applicable to commercial financial institutions, which are depositors of public funds. Governmental time deposits at June 30, 2010 and 2009 amounted to approximately $317,108,000 and $245,751,000, respectively.

Time deposits in denominations of $100,000 or more amounted to approximately $385,232,000 and $351,663,000 at June 30, 2010 and 2009, respectively.

(8) Securities Sold under Agreements to Repurchase

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to sell securities under agreements to repurchase The following table summarizes certain information on securities sold under agreements to repurchase:

		2010	2009
Carrying amount at June 30	$	177,750,000	184,485,000
Average amount outstanding during the year		172,154,000	158,130,000
Maximum amount outstanding at any month-end		190,400,000	186,638,000
Weighted average interest rate for the year		2.31%	2.75%
Weighted average interest rate at year-end		2.62	2.33

Securities sold under agreements to repurchase represent borrowings with maturities ranging from 6 to 1,366 days at June 30, 2010 and from 6 to 1,731 days at June 30, 2009.

(Continued)

As of June 30, 2010 and 2009, securities sold under agreements to repurchase were collateralized with mortgage-backed securities, other government agencies securities, and other investments with a market value of $191,106,000 and $201,400,000, respectively.

The activity for securities sold under agreements to repurchase during 2010 and 2009 was as follows:

	2010				
	Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Securities sold under agreement to repurchase	$ 184,485,000	545,821,798	(552,556,798)	177,750,000	63,450,000

	2009				
	Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Securities sold under agreement to repurchase	$ 164,428,000	847,756,000	(827,699,000)	184,485,000	79,685,000

(9) Promissory Notes and Other Note Payable

Promissory notes and other note payable at June 30, 2010 and 2009 are summarized as follows:

	2010	2009
Promissory notes	$ 456,320,815	293,000,000
Other note payable	10,755,699	11,150,942
Total	$ 467,076,514	304,150,942

On May 22, 2003, the Bank was authorized to issue up to $300 million in collateralized promissory notes. During the fiscal year 2005, the authorized amount was increased up to $500 million. During fiscal year 2008, the Bank, through its subsidiary EDBCI, was authorized to issue an additional $275 million in collateralized promissory notes. The proceeds received by the Bank from the sale of these notes shall be invested in obligations that qualify as permitted investments under applicable laws and the investment guidelines adopted by the Bank. Such notes have maturities not exceeding 20 years. These notes contain certain put options held by the Bank and by the creditor. The put options of the Bank grant the Bank the exercisable right, at the Bank's sole discretion, to require the noteholder to purchase, on established exercise dates, the collateral of this note at a price equal to the amortized cost of the promissory notes, as defined. The put option held by the noteholders permits them, on the same established dates of the Bank's put option, to require the Bank to redeem the promissory notes at their outstanding amortized cost. The mirror put options held by the Bank are considered in accounting for the fair value of the underlying investments. As a result, no separate asset or obligation is recorded related to the put options.

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At June 30, 2010 and 2009, the aggregate principal balance of promissory notes outstanding under these programs amounted to $456 million and $293 million, respectively. These notes pay interest semiannually, bear interest rates at June 30, 2010 ranging from 5.15% to 7.23%, and mature at various dates through June 15, 2023. These promissory notes are collateralized with investment securities with an aggregate fair value of $439,000,000, excluding the value of their corresponding put options.

The other note payable is due to GDB (collateralized by a real estate mortgage) bears interest at the rate of 6% per annum, pays interest semiannually in June and December, and principal is paid each June. The note matures on June 1, 2026 and provides for annual payments of $1,064,300 including interest.

Promissory notes and other note payable activity for the years ended June 30, 2010 and 2009 was as follows:

	2010				
	Beginning balance	**Increases**	**Decreases**	**Ending balance**	**Amounts due within one year**
Promissory notes	$ 293,000,000	181,320,815	(18,000,000)	456,320,815	—
Other note payable	11,150,942	—	(395,243)	10,755,699	418,958
Total promissory notes and other notes payable	$ 304,150,942	181,320,815	(18,395,243)	467,076,514	418,958

	2009				
	Beginning balance	**Increases**	**Decreases**	**Ending balance**	**Amounts due within one year**
Promissory notes	$ 615,000,000	—	(322,000,000)	293,000,000	—
Other note payable	11,523,814	—	(372,872)	11,150,942	395,243
Total promissory notes and other notes payable	$ 626,523,814	—	(322,372,872)	304,150,942	395,243

(Continued)

The maturities of the promissory notes and the note payable for each of the next five fiscal years and thereafter are as follows:

		Principal	Interest
Year ending June 30:			
2011	$	418,958	27,776,176
2012		444,095	27,750,913
2013		275,470,741	18,772,884
2014		498,985	10,645,749
2015		528,924	10,615,660
2016 – 2020		3,160,491	52,559,851
2021 – 2025		185,550,264	23,186,452
2026 – 2030		1,004,056	173,796
	$	467,076,514	171,481,481

(10) Other Liabilities

The activity for the other noncurrent liabilities during 2010 and 2009 was as follows:

		2010			
		Beginning balance	Increases	Decreases	Ending balance
Compensated absences	$	2,476,323	121,500	(374,838)	2,222,985
Legal claims		650,222	300,000	—	950,222
Reserve for loan guarantees		—	10,170,052	—	10,170,052
	$	3,126,545	10,591,552	(374,838)	13,343,259

		2009			
		Beginning balance	Increases	Decreases	Ending balance
Compensated absences	$	2,486,137	404,100	(413,914)	2,476,323
Legal claims		450,222	250,000	(50,000)	650,222
	$	2,936,359	654,100	(463,914)	3,126,545

(11) Net Assets

The Bank's net assets invested in capital assets and restricted as of June 30, 2010 and 2009 are composed of the following:

		2010	2009
Invested in capital assets, net of related debt:			
Capital assets	$	18,778,664	18,995,024
Accumulated depreciation and amortization		(9,261,984)	(9,084,755)
Related GDB note		(10,755,699)	(11,150,942)
Total	$	(1,239,019)	(1,240,673)
Restricted for special loan programs:			
Economic Development Administration	$	4,040,303	4,476,741
Day Care Centers Loan Fund		4,849,062	4,750,450
Total	$	8,889,365	9,227,191

The Bank is a recipient of two grants from the Economic Development Administration Directive System (EDA), subscribed to the U.S. Department of Commerce to operate a program under a Revolving Loan Fund directed to assist businesses that suffered physical or economic damage due to the effects of Hurricane Hugo, and to advance the economic development of Puerto Rico. The Bank matched EDA's award pursuant to the terms of the grant agreements. The funds received from the collection of principal and interest of loans granted under the program are deposited in the fund to be used to disburse new qualified loans. At June 30, 2010 and 2009, the outstanding principal of loans granted under the terms of EDA Revolving Loan Fund amounted to $3,759,415 and $4,191,561, respectively, and are included in loans in the accompanying statements of net assets. The grants are routinely subject to financial and compliance audits in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133 or to compliance audits by EDA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance.

On October 6, 1989, a revolving loan fund grant that was administrated by GDB was transferred to the Bank for administration under the same terms as when the program was established by GDB. At the time, such fund had a total contribution of $1,250,000 ($1,000,000 from EDA and $250,000 from GDB) and a portfolio consisting of 15 loans with an aggregate outstanding principal balance of $504,299. The fund was pooled into the fund previously administered by the Bank when the Bank reimbursed $250,000 to GDB for their original contribution to such fund. As a result, the Bank's contribution to the fund equals 25% of EDA's contribution to the fund.

The Commonwealth approved Law No. 212 of August 29, 2000, as amended, which creates the Day Care Centers Loan Fund, for the purpose of financing the development of day care centers for children, multiple activity centers for elderly persons, and long-term care institutions. The Bank is responsible for the administration of the fund. At June 30, 2010 and 2009, the outstanding principal of loans granted under the terms of the Day Care Centers Loan Fund amounted to $3,526,990 and $3,633,548, respectively, and are included in loans in the accompanying statements of net assets.

Restricted net assets related to the special loans programs as of June 30, 2010 and 2009 consist of the following:

		2010	2009
Cash and due from banks	$	2,854,015	2,832,931
Loans and interest receivable, net of allowance for loan losses of $1,568,904 and $1,669,427 in 2010 and 2009, respectively		5,729,408	6,188,359
Other assets		351,657	293,317
Total restricted assets		8,935,080	9,314,607
Accounts payable and other liabilities		45,715	87,416
Total restricted net assets	$	8,889,365	9,227,191

(12) Interagency Agreements

The Bank has entered into interagency agreements with various government agencies. Such agreements provide for the deposit of funds in the Bank amounting in the aggregate to approximately $1.9 million to be used for loan programs to benefit socially and economically disadvantaged families and unemployed persons. Loans are granted based on the requirements established by such governmental agencies and the Bank is responsible for the administration of the loan portfolio. At June 30, 2010, these fund programs had made payments of approximately $198,000 to the Bank for loans guaranteed; therefore, these loans are not included in the accompanying statements of net assets.

The Bank entered into an interagency agreement with the Economic Development and Commerce Department (a governmental unit of the Commonwealth). Such agreement provides for the transfer of the funds from the previously created Hurricane Georges Guarantee Loan Fund and the Education Loan Program Guarantee Fund to a new loan fund program. The new loan fund program grants direct loans and guarantees to small- and medium-sized entrepreneurs in the economic sectors of manufacturing, services, and commerce. Guarantee claims under Hurricane Georges Guarantee Loan Fund and Education Loan Program Guarantee Fund may be paid by the new fund. At June 30, 2010 and 2009, the outstanding principal of loans granted under all the Economic Development and Commerce Department loans and loan guarantee programs amounted to $10,245,614 and $13,409,400, respectively, of which $6,358,466 and $9,645,931, respectively, are included in loans in the accompanying statements of net assets, while the remaining balance had been paid to the Bank by the new fund.

The Bank entered into an interagency agreement with the Tourism Company of Puerto Rico (a component unit of the Commonwealth) to create the Loan and Guarantee Tourism Fund. At June 30, 2010 and 2009, the outstanding principal of loans granted under this fund amounted to $16,085,000 and $15,680,000, respectively, and are included in loans in the accompanying statements of net assets.

On August 17, 2001, the Commonwealth approved Law No. 117, which creates the Agricultural Guarantee Loan Fund to secure loans granted by the Bank and commercial banks to farmers and agricultural entities. This fund will be financed through annual appropriations to be provided by the Commonwealth up to

$100 million during a four-year period. The Bank has entered into an alliance with the Commonwealth's Department of Agriculture (the Department) for the administration of this fund, which among other things, requires that the Department establish the operational procedures of the Fund, while the Bank will administer the fund. At June 30, 2008, the fund had received $10 million related to the initial appropriation, which was deposited in the Bank. At June 30, 2010 and 2009, the outstanding principal of all loans granted under the Agricultural Guarantee Loan Fund program amounted to $15,864,246 and $16,957,171, respectively, of which $8,578,651 and $10,946,837, respectively, are included in loans in the accompanying statements of net assets, while the remaining balance had been paid to the Bank by the fund.

The Bank entered into an interagency agreement with the Department of Agriculture (a governmental unit of the Commonwealth) and the Fund for the Comprehensive Development of the Agriculture, a component unit of the Puerto Rico Land Authority (a component unit of the Commonwealth), to create the Guarantee Loan Program – "La Llave para tu Agro-empresa." At June 30, 2010 and 2009, the outstanding principal of loans granted under the program amounted to $3,576,693 and $2,782,108.

The financial statements of these funds are audited by other independent auditors whose reports thereon for the year ended June 30, 2009, dated August 31, 2009, express an unqualified opinion. Audit of these funds for the year ended June 30, 2010 has not been completed as of issuance date of the Bank's basic financial statements. These funds are not included within the Bank's basic financial statements.

The Bank and the governmental agencies participating in the interagency agreements described above are jointly liable for any litigation that may arise in connection with the administration of such loan programs. At June 30, 2010 and 2009, there was no pending or threatened litigation under such programs.

(13) Commitments and Contingencies

(a) Litigation

At June 30, 2010, the Bank is a defendant in various lawsuits arising from the ordinary course of business. Management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, resulting from such lawsuits would not be material in relation to the Bank's financial position and results of operations.

Because of the uncertainties inherent in the evaluation of pending or threatened litigation, the Bank's ultimate liability under such claims may be significantly different from management's current estimate.

(b) Loan Guarantee Program

On March 9, 2009, the Commonwealth approved Law No. 9, which creates the Loan Guarantees Program for the Small and Medium Businesses. Under the program, the GDB, a component unit of the Commonwealth, assigned $180 million to the Bank to secure loans granted by commercial banks and other financial institutions ranging from $5,000 to $250,000 and in accordance with the criteria established by the law and the Bank's policies. The purpose of this program is to facilitate credit to enterprises affected by lack of liquidity or lack of sufficient collateral to back up their loans. At June 30, 2010 and 2009, the outstanding principal of loans granted under the program amounted to $3,540,000 and $65,000, respectively.

At June 30, 2010 and 2009, total outstanding loan guarantees, including guarantees under the new program mentioned above, amounted to approximately $3,874,000 and $429,000, respectively. The Bank has recorded an accrual for losses on loan guarantees amounting to approximately $10,170,000 and $170,000 at June 30, 2010 and 2009, respectively, which is included in other current liabilities in the accompanying statements of net assets. During 2010, the Bank received $10 million from the GDB to cover any losses that may arise from the operation of the Loan Guarantees Program described above. This amount was recorded in the accrual for losses on loan guarantees under noncurrent other liabilities in the accompanying financial statements. See note 20 on related-party transactions.

(c) Other Risks

The Bank is exposed to various risks of loss related to torts, theft, casualty, errors, and omissions and other losses for which the Bank carries commercial insurance. Settled claims have not exceeded insurance coverage in any of the past three fiscal years. Also, the Bank obtains workers' compensation coverage from another component unit of the Commonwealth.

(14) Fair Values of Financial Instruments

The following summarizes the methods and assumptions used by the Bank in estimating the fair values of financial instruments:

- *Cash and Due from Banks* – The amount reported in the statements of net assets for cash and due from banks approximates its fair value.
- *Securities Purchased under Agreements to Resell* – Maturity dates of securities purchased under agreements to resell at June 30, 2010 and 2009 are less than one year. The amount reported in the statements of net assets approximates its fair value due to the short-term maturities and the nature of the instruments.
- *Investment in Debt Securities* – Debt securities are carried at fair value. Debt securities that are primarily traded in secondary markets were valued using market prices, pricing models, or quoted market prices of financial instruments with similar characteristics.
- *External Investment Pools and Equity Investments* – The fair value of investment positions in external investment pools was estimated by the pools' managers in the absence of readily ascertainable market values. The Bank uses net asset value of the investment pools as a practical expedient to compute the fair value of its investment positions. The carrying value of investments in equity securities of local enterprises approximates fair value as estimated by management based on an evaluation of the investees' financial position.
- *Loans* – Given the type of development loans originated by the Bank, and the level of nonaccrual and impaired loans, it is not practicable to estimate fair value of the portfolio.
- *Accrued Interest Receivable* – The amounts reported in the statements of net assets approximate fair value because of the short-term nature of this balance.

- *Time Deposits* – Maturity dates of time deposits range from 1 to 182 days. The carrying amounts approximate their fair values at the reporting date due to the short-term maturities.
- *Securities Sold under Agreements to Repurchase* – Maturity dates of securities sold under agreements to repurchase at June 30, 2010 and 2009 are less than one year except for seven securities amounting to $114.3 million, which mature between September 29, 2011 and March 4, 2013. The fair value at the reporting date of the short term instruments approximate its carrying amounts. It is not practicable to determine the fair value of the long term instruments.
- *Promissory Notes and Other Note Payable* – The fair value of promissory notes with variable interest rates and of the other note payable with a fixed rate approximates their carrying value, considering related put options. Pertinent information concerning these transactions is provided in note 9.
- *Accrued Interest Payable* – The amounts reported in the statements of net assets approximate fair value because of the short-term nature of this balance.

The carrying value and fair value of financial instruments are as follows:

		2010		2009	
		Carrying value	**Fair value**	**Carrying value**	**Fair value**
		(In thousands)			
Financial assets:					
Cash and due from banks	$	3,582	3,582	2,507	2,507
Securities purchased under agreements to resell		167,655	167,655	109,400	109,400
Investments		786,192	786,192	618,560	618,560
Loans		215,685	N/A	213,053	N/A
Accrued interest receivable		5,082	5,082	2,758	2,758
Financial liabilities:					
Time deposits	$	385,279	385,279	351,723	351,723
Securities sold under agreements to repurchase-short term		63,450	63,450	79,685	79,685
Securities sold under agreements to repurchase-long term		114,300	N/A	104,800	N/A
Promissory notes and other note payable		467,077	467,077	304,151	304,151
Accrued interest payable		2,462	2,462	1,279	1,279

(15) Significant Group Concentrations of Credit and Market Risk

The Bank's business activities are with customers located in Puerto Rico. The Bank's loan transactions are all directed toward small- and medium-size businesses in all sectors of Puerto Rico's economy. The collateral held on the Bank's loans varies, but usually includes chattel and real estate mortgages.

(16) Retirement Plans

(a) Defined Benefit Pension Plan

The Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) created pursuant to Act No. 447 of 1951, as amended, is a cost sharing multiple employer defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. All regular employees of the Bank hired before January 1, 2000 and under 55 years of age at the date of employment became members of the ERS as a condition to their employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

The System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability benefits are available to members for occupational and nonoccupational disabilities. However, a member must have at least 10 years of service to receive nonoccupational disability benefits. Retirement benefits depend upon age at retirement and number of years of creditable service. Benefits vest after 10 years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than $200 per month.

Participants who have completed 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise, they will receive 75% of the average compensation, as defined.

Commonwealth legislation requires employees to contribute 5.775% for the first $550 of their monthly gross salary and 8.275% for the excess of $550 of monthly gross salary. The Bank is required by the same statute to contribute 9.275% of the participant's salary.

(b) Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305, which amends Act No. 447, to establish, among other things, a new defined benefit contribution savings plan program (System 2000).

System 2000 became effective on January 1, 2000. Employees participating in the System as of December 31, 1999 elected either to stay in the defined benefit plan or to transfer to System 2000.

(Continued)

New regular employees of the government on or after January 1, 2000 became members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which is invested by the System, together with those of the System. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on the employees’ contribution (with a minimum of 8.275% of the employees’ salary up to a maximum of 10% of the monthly gross salary), which will be invested in one of three investment options. The Bank’s required contribution is 9.275% of the employees’ salary.

System 2000 reduces the retirement age from 65 years to 60 years for those employees who joined the current plan on or after April 1, 1990.

Total employee contributions during the years ended June 30, 2010, 2009, and 2008 to the above plans amounted to approximately $480,000, $512,000, and $469,000, respectively. Total payroll covered for the years ended June 30, 2010 and 2009 was approximately $5,850,000 and $6,253,000, respectively.

The Bank’s contributions during the years ended June 30, 2010, 2009, and 2008 to the above plans amounted to $543,000, $580,000, and $532,000, respectively, which represented 100% of required contributions.

Additional information on the System will be provided in its financial statements for the year ended June 30, 2010. That report may be obtained by writing to Employees’ Retirement System of the Commonwealth and its Instrumentalities, P.O. Box 42003, San Juan, PR 00940 2003.

(17) Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Bank is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and to purchase investment and mortgage-backed securities, financial guarantees, and interest rate exchange agreements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the accompanying statements of net assets. These off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Bank’s exposures to credit losses for lending commitments are represented by the contractual amount of such transactions. The notional amounts for other off-balance-sheet risks express the dollar volume of the transactions, but the credit risk might be lower.

At June 30, 2010 and 2009, the off-balance-sheet risks consisted of the following:

		2010	2009
		(In thousands)	
Financial instruments whose credit is represented by contractual amounts:			
Financial guarantees	$	3,874	429
Commitments to extend credit		36,122	31,084
Commitments to invest in venture capital		13,847	18,311

Financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing financial guarantees is essentially the same as that involved in extending loan facilities to customers.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include property, plant, and equipment, and income-producing commercial properties.

(18) Other Noninterest Income

Other noninterest income for the years ended June 30, 2010 and 2009 consists of the following:

		2010	2009
Rental income (note 5)	$	405,647	499,144
Gain (loss) on sale of foreclosed assets		218,440	(6,750)
Administrative fees – other funds		128,675	116,746
Recoveries from loan guarantees		18,183	37,505
Miscellaneous income		343,805	401,881
Total	$	1,114,750	1,048,526

(Continued)

(19) Other Noninterest Expenses

Other noninterest expenses for the years ended June 30, 2010 and 2009 consist of the following:

		2010	2009
Electricity	$	458,389	502,420
Insurance		219,549	210,881
Repairs and maintenance		149,832	169,017
Telephone		83,224	113,503
Employees trainings and seminars		8,165	15,019
Office supplies		52,863	62,667
Reimbursement of expenses to employees		97,841	87,851
Dues and subscriptions		61,044	68,361
Investment operations		26,311	33,474
Vehicles		4,066	13,815
Postage		25,666	28,659
Official meetings		5,872	13,346
Miscellaneous		172,768	197,820
Subtotal		1,365,590	1,516,833
Legal claims		300,000	250,000
Provision for losses on foreclosed assets		300,000	300,000
Total	$	1,965,590	2,066,833

(20) Related-Party Transactions

On February 1, 2010, the Governor of Puerto Rico issued Executive Order OE-2010-005, which reassigned funds remaining from the local economic stimulus plan approved under Law No. 9 of the Commonwealth in March 9, 2009. In accordance with this order, the Bank received from GDB $41,250,000 to implement a program designed to promote the economic capacity of small- and medium-size enterprises. Of this total, the Bank recorded $30 million as a capital contribution aimed to generate new direct loans, $10 million as a reserve for possible losses from the Loan Guarantee Program created by the abovementioned Law No. 9, and $1,250,000 as an accrual for expenses related to a governmentwide effort to promote economic development of the small- and medium-size enterprise sector.

(21) Subsequent Events

On July 20, 2010, the Bank accepted an offer from the issuer of $75 million floating rate notes (the Notes) due on September 12, 2010 to redeem the Notes at 109%. As a result, the Bank recorded a gain of approximately $7.7 million on this investment existing at June 30, 2010.

The Bank evaluated subsequent events through September 30, 2010, the date the basic financial statements were available to be issued.